U.S. Senate
Republican Policy
Committee

Larry E. Craig, Chairman
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Legislative Notice

Editor, Judy Gorman Prinkey

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S. 1133 — Parent and Student Savings Account PLUS Act

Calendar No. 311

Reported from the Committee on Finance in the nature of a substitute, and with an amendment to the title, February 19, 1998, by a vote of 11 to 8; Minority Views filed. S. Rept. 105-164.

NOTEWORTHY

- At press time, it was expected that the Majority Leader would attempt to turn to the consideration of the education savings bill on Friday, with the possible filing of a cloture petition on the motion to proceed to the House-passed bill, H.R. 2646 (Senate Calendar item No. 227). [See Background for details.]

- S. 1133 provides some $6 billion (over 10 years) in tax relief for education.

- S. 1133 expands the recent education savings account changes included in the Taxpayer Relief Act of 1997 [P.L. 105-34] by increasing the annual contribution limit for education IRAs from $500 to $2,000 for taxable years 1999 through 2002. The bill also expands the definition of qualified education expenses (currently limited to higher education) to include K through 12 expenses.

- The bill provides an exclusion from gross income for distributions made from a qualified state tuition program. Distributions must be made for qualified education expenses related to attending college (including graduate school) or vocational school.

- S. 1133 extends the current-law section 127 tax exclusion from May 31, 2000, to December 31, 2002, and permits graduate-level courses to be included in the section 127 tax exclusion from an employee's gross income for employer-provided (up to $5,250 a year) education assistance.

- The bill assists local governments in issuing bonds for school ~~construction~~ by increasing the small-issuer exception from $10 million to $15 million, provided that at least $10 million of the bonds are issued to finance public schools.

- The bill contains nearly $6.9 billion in offsets (revenue raisers) over 10 years to come from modifications to the employer deduction for vacation pay ($3.6 billion), and treatment of the foreign tax credit carryback and carryforward periods ($3.3 billion).

BACKGROUND

Current Procedural Situation

Because S. 1133 includes a revenue provision, the House exercised its "blue slip" prerogative based on the constitutional requirement that revenue bills originate in the House. Therefore, the Senate likely will be voting on the motion to proceed to the House bill which, if successful, would allow the Senate to move to substitute the Senate language in S. 1133 for the House language. H.R. 2646 passed the House on October 23 by a vote of 230-198.

Legislative History

By a vote of 59 to 41, the Senate adopted Senator Coverdell's K-through-12 Education Savings Accounts proposal as an amendment to the Taxpayer Relief Act (TRA) on June 27, 1997 (vote No. 150). The provision was included in the final budget agreement reached with the White House, but due to a last-minute veto threat from President Clinton, the language was dropped from the conference report (H.R. 2014) prior to its consideration in the House and Senate. The TRA became law with education IRAs limited to $500 per student annually, and limited to higher education expenses (see below).

The Coverdell proposal was again considered in the Senate as a freestanding bill (H.R. 2646, "Gingrich-Archer") just prior to *sine die* adjournment. Two attempts were made to invoke cloture on the bill. On October 31, the Senate failed to invoke cloture by a vote of 56 to 41 (vote No. 288) and again failed to cut off debate on the measure on November 4, by a vote of 56 to 44 (vote No. 291). [For further details on H.R. 2646, refer to RPC Legislative Notice No. 44, issued October 29, 1997.]

Current Law

The Taxpayer Relief Act of 1997 provides tax exempt status to education IRAs that are established to pay for the expenses of higher education only. Contributions to an education IRA may not exceed $500 per-beneficiary annually and may not be made once the beneficiary reaches age 18. The annual $500 contribution limit is phased out ratably for contributors with modified adjusted gross income (AGI) between $95,000 and $110,000 for individuals and between $150,000 and $160,000 for joint filers.

BILL PROVISIONS

Title I

A-PLUS Education Savings Accounts

- S. 1133 increases the annual contribution limit from $500 to $2,000 for education IRAs and expands the definition of "qualified education expenses" to include the costs of elementary and secondary education (including home schooling expenses).

- The new $2,000 limit will be in effect from January 1, 1999, through December 31, 2002. For 2003 and future years, annual contributions will revert to the $500 limit and will be limited to post-secondary education expenses.

- Qualified elementary and secondary expenses include (1) tuition, fees, academic tutoring, special needs services, books, supplies, as well as the cost of computers and other equipment incurred "in connection with the enrollment or attendance" of a student in a private or public school; and (2) room and board, uniforms, transportation and supplementary items (including after-school care), "required or provided by a school for enrollment or attendance."

- The bill removes the current age limit (i.e., age 18) for contributions made on behalf of a special needs individual. For special needs individuals, the bill also removes the current age limit (i.e., age 30) by which any remaining balance in an education IRA must be distributed.

- The bill clarifies that corporations and other entities (e.g., charitable organizations, foundations, etc.) are permitted to make contributions to an education IRA, regardless of the corporation's income for that year.

- The bill retains the current-law eligibility requirements for high-income individuals. Contributions are phased out ratably at incomes between $95,000 and $110,000 (for individuals) and $150,000 and $160,000 (for joint returns).

- These provisions provide $1.64 billion in tax relief over 10 years.

Qualified State Tuition Programs

- The bill provides for the tax-exempt treatment of funds distributed from a qualified state tuition program. Amounts distributed for the qualified education expenses of attending a college, university (including graduate school), or vocational school are not included in the gross income of the contributor (or the beneficiary) for tax purposes.

- The exclusion from gross income is not permitted in cases where a HOPE or Lifetime Learning credit is claimed on behalf of a student.

- If a parent chooses to claim a HOPE or a Lifetime Learning credit for a dependent, then the earnings portion of a distribution made to a student from a qualified state tuition program will be included in the gross income of the student.

- These provisions provide $1.57 billion in tax relief over 10 years.

Extension of Employer-Provided Education Assistance

- The bill extends to December 31, 2002, the current-law exclusion from an employee's gross income amounts paid or incurred by an employer for education assistance provided to the employee. The provision is scheduled to expire with respect to courses beginning after May 31, 2000.

- The bill also reinstates the tax exclusion for graduate level courses.

- The exclusion is limited to $5,250 of education assistance per employee in any calendar year.

- These provisions provide $2.63 billion in tax relief over 10 years.

Small Issuer Exception for Government Bonds

- The bill increases local governments' small issuer exception to $15 million, provided that at least $10 million of the bonds are issued to finance public schools.

- Under current law, arbitrage profits earned on tax-exempt bonds must be rebated to the federal government. However, an exception (the "small issuer exception") allows local government units to issue government bonds without the arbitrage rebate requirement in order to encourage public school construction. The current limit on the small issuer exception is $10 million for government units that issue at least $5 million in bonds for public schools during the calendar year.

- These provisions cost $194 million over 10 years.

Tax-Free Treatment of National Health Corps Scholarships

- The bill would allow students who receive a National Health Corps scholarship to exclude the dollar value of the scholarship from their gross income for tax purposes. The tax-free treatment will be extended to scholarships received by medical, dental, nursing, and physician assistant students under the National Health Corps Scholarship Program.

- Consistent with current law, the tax-free treatment does not apply to amounts received by students to cover regular living expenses, such as room and board.

- These provisions have a negligible cost (according to the Joint Tax Committee).

Title II
Revenue Offsets

Pay-as-you-go procedures under the Budget Act require offsets in mandatory spending for any legislation that decreases revenues. As reported from the Finance Committee, the bill contains two offsets totaling $6.88 billion over fiscal years 1998-2008.

Employer Deduction for Vacation Pay

The bill provides that, for purposes of determining whether an item of compensation (other than severance pay), is deferred compensation, the compensation is not considered to be paid or received until it is actually received by the employee.

In addition, an item of deferred compensation is not considered paid to an employee until it is actually received by an employee.

The bill overrules the *Schmidt Baking* decision which held that letters of credit may constitute actual receipt by the employee of an item of deferred compensation.

The Joint Committee on Taxation (JCT) estimates that this provision will increase tax revenue by $3.6 billion over 10 years.

Modification to Foreign Tax Credit Carryover Period

The bill reduces from two years to one year the carryback period for excess foreign tax credits. The bill also extends the excess foreign tax credit carryforward period from five years to seven years.

JCT estimates that these modifications will increase tax revenue by $3.26 billion over 10 years.

ADMINISTRATION POSITION

The President and his advisers have issued numerous veto threats against legislation extending the use of education IRAs to elementary and secondary education. In a March 12, 1998 Statement of Administration Policy, the White House reiterated its strong opposition to expanding education savings accounts. According to the statement:

> "If S. 1133, or its House companion measure H.R. 2646, were presented to the President, the Secretaries of Education and the Treasury would recommend that he veto the bill because it is bad education policy and bad tax policy."

COST

The Joint Committee on Taxation projects 10-year costs for the Education IRAs to be $1.644 billion; the qualified state tuition programs provision to be $1.568 billion; the employer-provided education assistance expansion to be $2.627 billion; and the small-issuer arbitrage rebate exception to be $194 million. Total 10-year cost is $6.033 billion, with revenue offsets (described above) of $6.877 billion.

OTHER VIEWS

Senators Moynihan, Baucus, Rockefeller, Conrad, Moseley-Braun, Bryan, and Kerrey jointly filed Minority Views in the committee report, beginning on p. 29.

POSSIBLE AMENDMENTS

Daschle. Substitute that would delete K-12 provisions, and add school construction.

Unknown. To reduce income phaseouts (Sen. Rockefeller offered such an amendment in committee, which was defeated).

Unknown. To strike private school tuition.

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